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SUBJECT: AFFORDABLE HOUSING: A RAY OF LIGHT IN AN OTHERWISE GLOOMY
REAL ESTATE MARKET

REF: MUMBAI 436

¶1. (U) Summary: After a period of unprecedented growth, the Indian real estate sector is in the midst of a protracted slowdown. Housing prices are in a phase of adjustment; having been reduced 20-30% in the major metros, and developers are not sure they have yet hit the bottom. However, a ray of light has appeared that may stimulate new construction and new demand: affordable housing. End Summary.

A Once Booming Sector

¶2. (U) The Indian real estate sector saw enormous growth during the last five years. Investors dove into the stock market looking for high rates of return and ran up the market capitalization of publicly listed real estate developers. Developers outbid each other to increase the size of their land banks and land prices climbed to unheard of levels in major metros such as New Delhi, Mumbai, Bangalore and Chennai. Second-tier cities, such as Jaipur and Amritsar, also experienced sharp increases in real estate values. In March 2008, BPTP Limited, an Indian real estate company, outbid other larger developers to buy 95 acres of land in Noida (part of the Delhi National Capital Region - NCR) for USD 1.2 billion (approximately USD 2,500 per square meter), making it India's most expensive land deal. Then, in May 2008, an apartment in one of Mumbai's landmark buildings created a record when it sold for approximately USD 2,400 per square foot. However, as early as August, the sector began witnessing its first signs of trouble with some developers struggling after a too rapid expansion (reftel). In the months since, media have speculated that several developers were near bankruptcy, as they had become financially dependent on their stock market value or on the continued influx of new buyers to support existing construction, not unlike a Ponzi scheme.

¶3. (U) Anurag Kalra, Vice President, Investor Relations of DLF Limited, one of India's largest developers, told Econoff by mid-2008 the sector had become overrun with "fly by night players", prices for commercial and residential properties had skyrocketed and interest rates were high. Buyers became cautious and turned toward big realty companies like DLF when they made their purchases. Then in fall 2008, when the worldwide economic crisis hit, demand and liquidity in India all but evaporated. According to Kalra, activity in the real estate sector has significantly slowed with many realty companies in trouble, after massive erosion in their market capitalization, and facing a crisis of confidence by prospective buyers. Kalra told Econoff sales of luxury housing are minimal, commercial property deals are being deferred, big developers have stopped acquiring land and are sitting on huge land banks, and companies like BPTP Limited who overextended themselves have asked the government to either restructure their deals or let them out of the deals altogether.

Initial Industry Efforts to Revive Sector

¶4. (U) Kalra told Econoff that to combat the slowdown for existing projects both in the commercial and residential sectors, developers have tried a series of measures. First they offered incentives like furnished space or free gifts to increase demand and tried innovative marketing strategies. When this failed, developers cut prices by 10-15% but even that did not attract buyers. He further related both developers and buyers have adopted a wait and see attitude with developers on average only dropping prices by 10-15% and the majority of buyers staying out of the market. Kalra believes the reason buyers have held back is because they feel prices have not yet hit bottom, and in the case of residential buyers, they are also worried about job security. Kalra said the reason developers are reluctant to reduce prices further is because of the high cost to develop the existing properties.

¶5. (U) The situation is somewhat different for new residential projects that have not been deferred because construction costs are down. This is one of the reasons why, in February, DLF slashed prices by 20-30% on two new residential developments it is moving forward with in Hyderabad and Bangalore. Kalra said this seems to have finally resonated with buyers, resulting in 50% of the units in the two projects being committed already. However, Kalra believes it is too soon to tell whether another price correction will be required to sell the remaining units.

Government Starts Supporting Affordable Housing

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¶6. (U) The Government of India has recognized the lack of affordable housing in India as a serious problem. According to the Ministry of Housing & Urban Poverty Alleviation, India faces a housing shortage of 24.7 million with 99% of the shortage affecting the poorest part of the population. The GOI has classified this part of the population as the Economically Weaker Section (EWS) and Lower Income Group (LIG). (Note: An EWS monthly family income is approximately USD 64 while a monthly LIG family income is between USD 64 and USD ¶149. End note.) To address this enormous housing shortage, the GOI has put forth a series of initiatives under the heading "Affordable Housing for All" as part of its 11th Five Year Plan (2007-2012).

¶7. (U) The flagship initiative, introduced in 2007, is the Jawaharlal Nehru National Urban Renewal Mission (JNNURM). Under this program, approximately USD 4.4 billion was allocated to create 1.5 million affordable homes in 63 major cities for the EWS/LIG population. Although the GOI has not adopted a formal definition of what constitutes affordable housing for EWS/LIG, a special task force on "Affordable Housing for All" generally defines affordable housing for these groups as a unit with between 300 to 600 square feet, with a cost not to exceed four times the household gross annual income and the equal monthly installments (EMI)/rent not to exceed 30% of the household's gross monthly income. Under JNNURM, the central government partners with States and urban local bodies and subsidizes anywhere from 50-90% of construction costs. Pankaj Joshi, Director of Housing at the Ministry of Housing and Urban Poverty Alleviation, told Econoff money has been disbursed for 1.3 million houses which are at various stages of construction.

¶8. (U) Then in February of 2009, the Ministry presented the Interest Subsidy Scheme for Housing the Urban Poor (ISHUP), the prime beneficiaries once again being the EWS/LIG. Under this program, the central government will provide subsidies on loans of up to USD 2,500 for a total of 400,000 homes. Also in February, the GOI announced another USD 1.2 billion had been set aside for the construction of an additional 1 million affordable homes. Director Joshi told Econoff that this money will be spent on Public-Private Partnership projects with the central government's money going toward paying up to 25% of total infrastructure costs. The beneficiaries of this initiative include not only the EWS/LIG, but also the middle income group (MIG) and includes building housing

units up to 1,200 square feet. A requirement of the program is that developers must set aside 25% of the development for EWS/LIG housing. Joshi noted the initiative is so new that all the details have yet to be worked out, but should be finalized by the end of March.

¶10. (U) Prior to the slowdown, developers had focused on commercial properties and/or high-end housing. However, a recent Federation of Indian Chambers of Commerce and Industry (FICCI) survey on the "Impact of Global Financial Crisis on Indian Real Estate Market" indicated that developers have finally recognized affordable and mid-range housing as areas of opportunity because of the dearth of low cost units. Mausami Roi, FICCI's Joint Director of the Real Estate Section, called affordable housing the one ray of light in a troubled sector. Babu Khan of the Confederation of Indian Industry (CII) echoed this sentiment. However, they both agreed that developers would likely focus first on mid-range housing because, to make a profit, units would have to be sold for between USD 25,000 and 50,000. Econoff asked DLF VP Kalra if DLF intended to enter the affordable housing market. He said it was likely but not in the immediate future. For the present, DLF intended to stay focused on its current projects.

¶11. (U) In January, government-owned State Bank of India lowered its interest rate on home loans of up to USD 50,000 to 8%. Other state-owned banks have been mandated to offer home loans at 8.5% for loans up to USD 10,000 and 9.25% for loans up to USD 40,000. According to FICCI's ROI, it is too early to gauge the impact the lower interest rates may have made, though she was hopeful they would lead to more buyers in the market. Neither ROI, CII's Khan, or DLF VP Kalra would say exactly when they thought the market would turn around, though they all believed the fundamentals of the sector were positive. They all hoped to see movement by the end of the year but when pressed said a real turnaround before 2010 was unlikely.

Real Estate Sector Seeks Special Status

¶12. (U) In addition to looking at affordable housing, the real estate industry is trying other methods to revive the sector. CII recently submitted a request to the Ministry of Housing & Urban Poverty Alleviation seeking "Industry" and "Infrastructure" status.

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The benefits of such special status includes reduced loan rates, low collateral levels requirements, fiscal incentives, access to subsidies, the raising of external commercial borrowings (ECBs), and tax breaks. CII believes the requested special status would lead to increased investment, create demand in the sector, and increase employment and overall growth in the economy. According to Director Joshi, the Ministry told CII that they must decide if they want "Industry" status or "Infrastructure" status because they can't have both. Joshi also said it was unlikely that any decision on granting special status would be made until after the new government was formed.

¶14. Comment: (SBU) Low interest rates on loans up to USD 50,000 coupled with the GOI's latest initiative on affordable housing could be the medicine India's real estate sector needs. If that fails, however, developers may find themselves in the position of having to slash prices even further and the GOI may have to grant special status to help the ailing sector.

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